No. 2822

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

JOHN H. MARTIN, as Trustee in Bankruptcy of the IMPERIAL COPPER COMPANY, a corporation, Bankrupt,

Appellant,

vs.

THE DEVELOPMENT COMPANY OF AMERICA, a corporation,

Appellee.

BRIEF ON BEHALF OF APPELLEE

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STATEMENT OF THE CASE

This appeal involves the validity of an order of the District Court of the United States, for the District of Arizona, granting defendant's (appellee's) motion to dismiss the bill of complaint, for the reason that it is insufficient of fact to constitute a valid cause of action in equity.

The bill of complaint was filed by appellant, as trustee of the Imperial Copper Company, bankrupt, an Arizona corporation (hereinafter called "Copper Company"), against The Development Company of America, a Delaware corporation (hereinafter called "Development Company"). It alleges that the appellee, Development Company, caused the appellant, Copper Company, to be organized, on, or about, May 11, 1903, as the "auxiliary, subsidiary, branch,

agent and instrumentality" of the Development Company, to carry into effect a certain contract executed by the Development Company for the purpose of operating and developing certain mining properties, of the value of five hundred and fifteen thousand ($515,000.) dollars, situated at Silver Bell, Pima County, Arizona; that the directors and officers of the Development Company were practically the same as those of the Copper Company; and that the Development Company owned practically all of the capital stock of the Copper Company.

It further alleges that the Development Company also caused to be organized, under the laws of Arizona, in the year 1903, or 1904, two "dummy" corporations, known as the Arizona Southern Railroad Company and the Southern Arizona Smelting Company (hereinafter called "Railroad Company" and "Smelting Company," respectively), in furtherance of its business of operating and developing said mining properties, and caused all of the capital stock of said Railroad Company and said Smelting Company to be issued to the Copper Company.

That the Development Company, in 1903, caused the Copper Company to execute a first mortgage, or deed of trust, upon said mining properties to secure a two million dollar bond issue of the Copper Company, for the use and benefit of the Development Company, and that the last named company used the stock of the Copper Company, and the proceeds of the sale thereof, in its business of purchasing, developing and operating mining and smelting properties in Arizona, and caused the capital stock of the Railroad Company and Smelting Company, theretofore transferred to the Copper Company, to be subjected, as additional security, to the lien of said mortgage or deed of trust executed by the Copper Company.

That the Development Company, on July 3, 1911, being at that time a holder of a majority of the bonds and capital

stock of the Copper Company, caused a suit to be instituted in the District Court of the First Judicial District of the Territory of Arizona at Tucson, Arizona, to foreclose said mortgage or deed of trust upon said mining properties of the Copper Company, and said capital stock of the Railroad Company and Smelting Company theretofore transferred by said last named companies to the Copper Company. That, under a decree of foreclosure, said properties were sold March 31, 1915, to Leo Goldschmidt, for the sum of ninety thousand ($90,000.) dollars for said mining properties and twelve thousand ($12,000.) dollars for said capital stock, for the use and benefit of the Development Company, or for the use and benefit of F. M. Murphy, president and chief officer of the Development Company, as representing the stockholders and bondholders of that company. That the said Murphy and the Development Company are now negotiating for the sale of said mining properties and the said capital stock, so purchased at said foreclosure sale by the said Goldschmidt, to the American Smelting & Refining Company, a New Jersey corporation.

That a petition in bankruptcy was filed against the Copper Company on July 5, 1911, in the District Court of the First Judicial District of the Territory of Arizona, by certain of its creditors, and on July 25, 1911, it was duly adjudged a bankrupt, and, at the first meeting of the creditors of said bankrupt, held on or about August 12, 1911, M. P. Freeman was elected as trustee, and acted as such until on, or about, July 2, 1914, he resigned, at which time appellant was duly elected, and qualified, as trustee in bankruptcy of the Copper Company. That the creditors' claims, filed and allowed in the bankruptcy proceedings of the Copper Company, total the sum of one million two hundred eighty thousand six hundred and eighty-six and 22/100 ($1,280,686.22) dollars.

That the action of the Development Company, in causing

said mining properties and said capital stock to be sold under said foreclosure proceeding, resulted in stripping the Copper Company of practically all its assets, with the exception of some personal property situated at the mines of the Copper Company, which the trustee caused to be advertised for sale at public auction; that insufficient moneys or property have come into the hands of plaintiff, as trustee in bankruptcy of the Copper Company, to pay any dividends upon the claims filed and allowed by the referee in bankruptcy.

That the appellee, Development Company, became, and is liable, for all of the debts of the appellant, Copper Company, as filed and allowed in the bankruptcy proceeding, amounting to the sum of $1,280,686.22, with interest at the rate of six per centum per annum from the date of allowance, and that said mining properties and said capital stock of the Railroad Company and the Smelting Company, purchased at said foreclosure sale by the Development Company, or for its use and benefit, are liable for all of said debts of the bankrupt Copper Company.

For these reasons the appellant, as trustee in bankruptcy of the Copper Company, asks for the following relief:

(1) For judgment against the *Development Company* in the sum of $1,280,686.22, the amount of the allowed creditors' claims in the bankruptcy proceedings of the Copper Company, with interest thereon at the rate of six per centum per annum.

(2) For judgment decreeing that said mining properties and said capital stock of the Railroad Company and the Smelting Company, pledged by the Copper Company as part security for said deed of trust, are liable for said creditors' claims.

(3) For judgment decreeing said creditors' claims to be liens upon the right, title or interest in, and to said mining

properties, and said capital stock acquired by the Development Company at said foreclosure sale.

(4) For judgment decreeing said mining properties and said capital stock of the Railroad Company and Smelting Company to be a part of the assets of the Copper Company to be administered upon by appellant, as trustee in bankruptcy of said Copper Company.

(5) For judgment decreeing that the Development Company pay over to appellant, as trustee in bankruptcy of the Copper Company, all moneys derived from the sale of any of said mining properties or said capital stock, to the extent of said creditors' claims.

(6) And for such special or general relief as may seem meet and proper in the premises.

ARGUMENT.

ASSIGNMENT OF ERRORS I AND II.

Appellant's first and second assignment of errors are directed to the order, judgment and decree of the lower court dismissing the bill of complaint upon the grounds of its insufficiency of fact to constitute a valid cause of action in equity, for the reason that defendant filed its motion to dismiss and answer at the same time.

By making this assignment of errors appellant evidently overlooks the provisions and manifest purpose of Equity Rule No. 29. It is there provided:

> "Every defense in point of law arising upon the face of the bill, whether for misjoinder, nonjoinder, or insufficiency of fact to constitute a valid cause of action in equity, which might heretofore have been made by demurrer or plea, shall be made by motion to dismiss, *or in the answer*, * * * *"

While defendant filed its motion to dismiss and answer, simultaneously, they are, nevertheless, separate pleadings. (Tr. of Rec. p. 22, *et seq.*) The answer specifically disclaimed any waiver of the motion to dismiss. Regardless of this, however, the defenses urged in the motion to dismiss

might have been urged in the answer, under Equity Rule No. 29, *supra.* It seems strange for appellant to argue that a rule, which permits a defendant to plead a defense of law in the motion to dismiss, *or answer,* does not permit a defendant to plead such a defense in the motion to dismiss, if an answer is also filed.

It is true that former Equity Rule No. 32 did not permit a defendant to demur, and plead to, and answer the bill at the same time, but present Equity Rule No. 29 abolishes pleas and demurrers, so we assume that the strict methods of interposing such pleas were abolished with them. The present equity rules were promulgated in order to liberalize the equity practice, so we take it that a motion to dismiss and answer, filed simultaneously, not only comports with the spirit, but the letter of Equity Rule No. 29, even though they were filed as separate pleadings. This must be true, if a defense of law may be presented by a motion to dismiss, or, at the option of the pleader, in the answer.

ASSIGNMENT OF ERRORS III AND IV.

Appellant's third and fourth assignment of errors are directed to the order, judgment and decree of the lower court holding the bill insufficient of fact to constitute a valid cause of action in equity. Both these assignments of error are so interrelated that they may be discussed, and disposed of, conjointly.

The bill of complaint cannot be sufficient of fact to constitute a valid cause of action in equity, unless the facts alleged disclose that the Development Company is liable for the debts and defaults of the bankrupt Copper Company. This is true, because the relief is asked against the Development Company. This liability, if any, results from the sole fact that the Development Company owns "practically all" of the capital stock of the Copper Company, elects its officers, controls and directs its affairs. So, the real question presented by the bill of complaint is this:

Does the mere fact that the Development Company owns "practically all" of the stock, and thereby controls the Copper Company, subject the former to a liability for the debts of the latter? An answer to this question naturally requires a discussion of the responsibility of a holding company for the liability of its subsidiary company, for such is the alleged relationship existing between the Development Company and the Copper Company.

THE DEVELOPMENT COMPANY, AS A HOLDING COMPANY OF THE COPPER COMPANY, IS NOT LIABLE FOR THE DEBTS AND DEFAULTS OF THE COPPER COMPANY UNDER THE FACTS PRESENTED BY THE BILL OF COMPLAINT.

From the allegations of the bill of complaint it will be observed that appellant, as trustee of the Copper Company, instituted his suit against appellee (Development Company), and asks, in effect, that the separate legal entity of those companies be disregarded upon the theory that the Copper Company was the mere "auxiliary, subsidiary, branch, agent and instrumentality" of the Development Company, so that the latter may be subjected to the payment of the debts of the bankrupt Copper Company, as evidenced by the approved claims allowed in bankruptcy against that company.

The fact that one corporation owns part, or all, of the stock of another corporation does not, *ipso facto,* make the one responsible for the debts and defaults of the other. If this were true it at once becomes apparent that the peculiar attribute of a corporation is destroyed, namely, the separate legal entity existing between the corporation and its stockholders.

It is said in *Cook on Corporations, Seventh Edition, Volume 1, Section 317,* as follows:

> "During the past ten years, there has sprung into existence a new kind of corporation, namely, a corporation organized not to do business itself, but to purchase

> and hold stock of other corporations, in order to secure harmony of control. * * * * The mere fact that a corporation is a separate entity is not conclusive in determining its relations with other companies. The courts have power to ignore the corporate existence, when such existence merely serves to conceal the truth. Nevertheless, it requires a strong case to induce a court of equity to consider two corporations as one, on account of one owning all the capital stock of the other."

It is not the purpose of the bill of complaint to subject the Development Company to the payment of debts which it contracted, but, on the other hand, to subject it to the payment of debts which the Copper Company contracted. There is nothing in the bill of complaint whatsoever which discloses that the creditors of the Copper Company considered the Development Company responsible for the former's indebtedness, or that they dealt with the Copper Company as a mere "auxiliary, subsidiary, branch, agent and instrumentality" of the Development Company. The debts of the Copper Company are all proved and allowed claims in the bankruptcy proceedings of that Company.

The authorities recognize the separate corporate existence between a holding company and its subsidiaries, and do not subject the one to the liabilities of the other, unless a strong case is made which discloses an exception to the general rule of separate corporate existence. This legal principle has been recognized and announced by many of the Courts. It is typically expressed by the Circuit Court of Appeals for the Sixth Circuit, in the recent case of *Pittsburg & Buffalo Co. v. Duncan et al., 232 Fed. 584,* decided May 2, 1916. That Court, speaking through Circuit Judge Knappen, said:

> "As respects stock ownership and corporate control: The mere fact that the stockholders in two or more corporations are the same, *or that one corporation exercises control over the other through ownership of its stock, or through identity of its stockholders,*

> *does not make either the agent of the other,* (italics ours) nor does it merge them into one, so as to make the contract of one corporation binding upon the other, where each corporation is separately organized under a distinct charter. (Citation of authorities.) True, the legal fiction of distinct corporate existence will be disregarded when necessary to prevent fraud, or when a corporation is so organized and controlled and its affairs so conducted 'as to make it only an adjunct or instrumentality of another corporation.' (Citation of authorities.) But 'it requires a strong case to induce a court of equity to consider two corporations as one, on account of one owning all of the capital stock of the other.' (Citation of authorities.)"

Again, this legal principle was announced by the Circuit Court of Appeals for the Second Circuit in the leading case of *In re Watertown Paper Co., 169 Fed. 252-256,* speaking through Circuit Judge Noyes, as follows:

> "Unless, therefore, it can be shown that some exception to the general rule of separate corporate existence and liability applies in this case, it must follow that the claim of the pulp company should have been allowed. The only exceptions to the rule, properly applicable here, are: (1) The legal fiction of distinct corporate existence may be disregarded when necessary to circumvent fraud. (2) It may also be disregarded in a case when a corporation is so organized and controlled, and its affairs are so conducted as to make it merely an instrumentality or adjunct of another corporation."

We use the foregoing excerpts, without stating the facts of the cases, merely to show the general rule touching upon the liability of a holding company for the debts of the subsidiary. It may be stated, generally, that a holding company is not liable for the debts of its subsidiary, except when necessary to circumvent fraud, or when the subsidiary is the mere instrumentality or adjunct of the other, *and*

then only in the clearest of cases. In view of the fact that there is no allegation of fraud in the bill of complaint we may eliminate from our discussion that exception to the general rule.

WAS, THEREFORE, THE DEVELOPMENT COMPANY (HOLDING COMPANY) RESPONSIBLE FOR THE DEBTS OF THE COPPER COMPANY (SUBSIDIARY COMPANY) BECAUSE THE LATTER WAS AN "AUXILIARY, SUBSIDIARY, BRANCH, AGENT AND INSTRUMENTALITY" OF THE FORMER?

Of course, the mere fact that the pleader alleges that the Copper Company was "an auxiliary, subsidiary, etc.," of the Development Company does not make it such. We are now dealing with the facts of the bill and not the pleader's conclusions.

The case of *In re Watertown Paper Co., supra,* is demonstrative of the application of the general rule and its exceptions. There the stockholders of the Watertown Paper Company organized a separate corporation and called it the H. Remington & Son Pulp & Paper Company. The stock of one was virtually owned by the stockholders of the other. The Pulp Company was financed, during its organization period, from funds of the Paper Company. The Paper Company became bankrupt, and the Pulp Company presented its claim for merchandise furnished by the Pulp Company to the Paper Company. The claim was rejected, as was stated, because there was such an identity of corporate interests that a claim presented by the Pulp Company against the Paper Company was nothing more or less than the bankrupt presenting a claim against itself. The Circuit Court of Appeals, in reversing the District Court, said:

> "It is true that the two corporations neglected their affairs. A creditor of one company might perhaps have a claim, based upon the principles of estoppel, against the other. Lax business methods are clearly shown.

> Undoubtedly the controlling stockholders regarded the two corporations as being, in a general way, different departments of their business. But the separate corporation organizations were apparently kept up. Each corporation had its own creditors, its own assets, and conducted its business in its own name. Books of account were kept, showing their financial relations. The stockholders were not entirely the same. We cannot, upon these facts, hold that the corporations were identical, nor that the Pulp Company was merely an adjunct or instrumentality of the Paper Company. Instead of coming under the exceptions, this case seems clearly to come within the general rule that the distinct corporate existence of two separate, although associated corporations, will be regarded by the courts."
>
> "For these reasons, we think the claim of the Pulp Company should have been allowed against the bankrupt estate of the Paper Company."

It is true that the identity of interests between the Paper Company and the Pulp Company was occasioned by similarity of individual stock ownership in the two companies, but we apprehend that there is no difference, in so far as the application of the principle of law is concerned, between two corporations whose stock is owned by virtually the same individual stockholders, and two corporations, the stock of one of which is owned by the other. The vital question, in both instances, when liability is involved, is the preservation or destruction of the legal fiction of separate corporate entity.

In the case which we have immediately quoted from, Judge Noyes discusses the principles of estoppel, arising from a debtor's liability created by one corporation holding itself out as responsible for the debts of another. Here, as there, this principle is inapplicable, because there is no allegation of the bill of complaint which discloses that the

Development Company ever held itself out as responsible for the debts of the Copper Company.

The case of *B. & O. Tel. Co. v. Interstate Tel. Co., 54 Fed. 51,* discloses that the Baltimore and Ohio Railroad Company organized several corporations to control and operate the Railroad Company's telegraph system. The corporations so organized by the Railroad Company were managed and controlled by it. The telegraph plant of the Baltimore and Ohio Telegraph Company of Baltimore County, one of the telegraph companies so organized, was sold by the Railroad Company to the Western Union Telegraph Company. Thereafter the Interstate Telegraph Company obtained a judgment against the Baltimore and Ohio Telegraph Company, and execution was issued on the judgment and returned *nulla bona.* Whereupon, suit was instituted against the Baltimore and Ohio Railroad Company and judgment obtained for a restitution of the debt of the Baltimore and Ohio Telegraph Company. The Baltimore and Ohio Railroad Company had sold the property of the Baltimore and Ohio Telegraph Company and thereby stripped it of its assets in disregard of its creditors, and the proceeds of the sale were "received and appropriated" by the Baltimore and Ohio Railroad Company. This fact, as appears from the opinion, at page 52 of the Reporter, undoubtedly gave rise to the following language of the Court:

> "When, therefore, the Baltimore and Ohio Railroad Company took possession of, controlled and *appropriated this property and its proceeds it took them impressed with these trusts, and is bound by them.* (Italics ours.) This result follows, whether it acted as sole beneficial owner of all its stock, or as creditor who had made large advances, or as principal who had placed large and valuable asets in the hands of its agent, as ostensible owner, *and thus secured its credit.* (Italics ours.) * * * *"

Certainly, the Baltimore and Ohio Railroad Company

was liable to the Interstate Telegraph Company for the debts of its subsidiary, the Baltimore and Ohio Telegraph Company, because the first company sold the property of the last company and received and appropriated the proceeds of the sale to its own use. These proceeds were impressed with pre-existing debts, so as to constitute a trust fund for the payment thereof. But the Development Company, in the case at bar, received no moneys from the judicial sale of the property held by the Copper Company. Indeed, the property described by the bill of complaint was *judicially* sold to satisfy a debt of the Copper Company, and the proceeds of the sale were applied towards a discharge of that debt. All of the proceedings had in connection with the sale of the properties held by the Copper Company were of a judicial character, the validity of which, we submit, has been finally determined by the Supreme Court of Arizona in the case of *Martin v. Bankers' Trust Company, 156 Pac. 87.*

The case of *In re Muncie Pulp Co. 139 Fed. 546,* would, from a superficial examination, seemingly support appellant's theory upon which his bill of complaint is framed. A careful examination of the facts of that case, however, will disclose that it falls within one of the recognized exceptions to the general rule of separate corporate existence. The opinion discloses that the Muncie Pulp Company, a New York corporation, was engaged in manufacturing pulp at Muncie, Indiana, its stock being owned by Henry Blackman, as president, and Gustav Jaeger, as treasurer. Thereupon, the Pulp Company organized, under the laws of Indiana, the Buck Creek Natural Gas Company to furnish the Pulp Company with gas and oil. Thereupon, and for technical reasons, a new company, known as the Great Western Gas and Oil Company, was organized to take the place of the Buck Creek Company, Blackman, as president, holding fifty-three per cent of its stock, and Jaeger, as treasurer,

holding forty-seven per cent of its stock. To the Great Western Gas and Oil Company was transferred the gas and oil well property, formerly owned by the Pulp Company, and by it transferred to the Buck Creek Company. Various expenditures were made by the Pulp Company for the Great Western Company, the former treating the latter merely as an agent, "which the law made necessary for the full development of its business." The Great Western Company kept no separate books, its entire administration being under the control of the Pulp Company. The record failed to show that there were any creditors of the Great Western Company. On December 16, 1914, the Muncie Pulp Company was adjudicated a bankrupt, and, thereupon, the receiver of the Pulp Company presented a petition to the District Court for the Southern District of New York, praying that the Great Western Company turn over to him the property which had been transferred to it. The petition was granted, and the order of the Court in this respect was thereafter affirmed by the Circuit Court of Appeals for the Second Circuit. An excerpt from the opinion will be sufficient to distinguish the facts of that case from the one at bar. At pages 546 and 547 of the Reporter, Judge Coxe, speaking for the Court, said:

> "The Muncie Pulp Company made various expeditures of its own money for the benefit of the Great Western Company, treating the latter merely as an agent, *which the law made necessary for the full development of its business.*" (Italics ours.) "The Great Western Company kept no separate set of books, and its entire administrative department being under the control of the Muncie Company. *The record fails to show that there were any creditors of the Great Western Company.*" (Italics ours.)

The statement of facts by the Court discloses that the Great Western Company was simply an agent of the Mun-

cie Company, which the law made necessary for the full development of its business. Indeed, the subsidiary had no creditors. These facts admittedly brought the liability of the Muncie Pulp Company within the exceptions of the general rule.

Again the Court, speaking at page 548 of the Reporter, says:

> "The Great Western Company was undoubtedly a mere creditor of the Pulp Company, having no independent business existence and organized solely for the purpose of facilitating the business of the latter. The Great Western Company has no shadow of claim to the property in controversy, and to permit it, or its president, or stockholders, to dispose of such property, *is to sanction a fraud upon the creditors of the Pulp Company.*" (Italics ours.)

Thus, we ascertain the Great Western Company, by transferring the property sought to be subjected to the liabilities of the Muncie Pulp Company, would perpetrate a fraud upon the creditors of the latter company. Of course, fraud destroyed the separate, corporate entity existing between the two corporations. But, in the case at bar, as before stated, there is no allegation of fraud, hence the above case has no application.

The case of *In re Reiger, Kapper and Altmark, 157 Fed. 609,* discloses a situation where a partnership, in contradistinction to a corporation, owned ninety-nine per centum of the capital stock of the company. The partnership was involuntarily adjudged a bankrupt. An application was made to extend the partnership receivership to the corporate assets, because, as it was alleged, the corporation was a subsidiary of the partnership. The receivership was so extended, but the facts of the case disclose that it was a proper case to disregard the separate entity of the corporation. For instance, Sater, J., District Judge, at page 611, said:

> "The corporate organization, it is true, was main-

tained, but it was for the purpose of facilitating and benefiting the partnership business. It was a mere adjunct to the partnership. The partners acquired the corporate stock, made themselves directors of the corporation, and owned, operated and controlled both concerns, and used the corporation's trade mark on their bill heads. *They shared in the profits made and losses sustained by the company. These four men constituted themselves as partners a selling agency to dispose of their own manufactured product."* (Italics ours.)

Certainly this statement of the District Judge reveals such an identity of interest between the partners and corporation that the one should have been liable for the responsibilities of the other. That the partnership and corporation mutually shared the profits and losses discloses the true relationship existing between them. Besides, the opinion further discloses that the scheme of operating the partnership and corporation was fraudulent in law, and hindered and delayed the creditors of the bankrupt estate in the pursuit of their legal remedies. No such situation is disclosed by the pleadings in the case at bar. Indeed, there is no attempt to justify the relief asked for here upon a plea of fraud.

The case of *Clere Clothing Company v. Union Trust & Savings Bank, 224 Fed. 363,* decided by this court, is illustrative of an application of the exceptions to the general rule of separate corporate existence. In that case the court refused to sanction a claim by the Clere Clothing Company against the Prager-Schlesinger Company, because the evidence disclosed that the latter company was created solely as the selling agent of the former, and, that in operating, both companies were virtually one. It was properly held by this court that such a scheme of organization would permit the Clere Clothing Company to prove debts against the Prager-Schlesinger Company in fraud of creditors. This

court, at page 366 of the Reporter, speaking through Judge Morrow, said:

> "We are of opinion that the evidence indicates conclusively that, commencing with the reorganization of the Prager-Schlesinger Company in July, 1912, down to and including the filing of the voluntary petition in bankruptcy by that company in August, 1913, it was acting solely in the capacity of agent for the Clere Clothing Company and that the presentation for payment of the claims involved in this proceeding is a deliberate attempt on the part of the latter company to prove debts against itself in fraud of legitimate creditors of the bankrupt corporation. The fact that the two companies preserved separate entities does not detract in the slightest degree from the force of the facts adduced in the testimony and hereinbefore referred to. The Clere Clothing Company and the Prager-Schlesinger Company, during the period referred to, were, as it were, one corporation. The scheme of the Clothing Company is easily discerned. It proposed to play safe regardless of the ultimate financial condition of the Prager-Schlesinger Company. If the latter company should be successful, there can be no doubt that the profits would have gone to the Clere Clothing Company, or to the National Bank of Commerce in payment of the indebtedness of the Clothing Company. If the Prager-Schlesinger Company should fail, as it did in fact fail, the Clothing Company proposed to be in a position to present and insist upon the payment of its alleged claims. Such tactics are not to be commended. A corporation may not for a period of over a year so intertwine its afairs and business transactions with a second company as to virtually create the relationship of principal and agent, and then upon the insolvency of the second company insist upon the payment of alleged debts incurred in the very transaction by which the relationship was created."

It is easy to discern that the present bill of complaint does not disclose such an identity of interest between the Development Company and the Copper Company as the

facts of the above case disclose between the Clere Clothing Company and the Prager-Schlesinger Company, and, besides, there the whole scheme of operation was considered a fraud upon creditors, a situation very much different from that disclosed by complainant's bill of complaint.

In the case of *Joseph R. Foard Company v. State of Maryland, 219 Fed 827,* the Circuit Court of Appeals for the Fourth Circuit had under consideration suits in admiralty by the State of Maryland to the use of Frances Goralski, et al., against the Joseph R. Foard Company, General Stevedoring Company, the Mayor and City Council of Baltimore City and the Munson Steamship Line; and also a suit in admiralty by Gustave Lies against the same respondents and the Maryland Steamship Company. All of the suits involved an accident arising out of an explosion on the British Steamship Alum Chine, lying in the quarantine anchorage off the port of Baltimore on the Patapsco River. Damages were adjudged to the libellants against the respondents, Joseph R. Foard Company, and the General Stevedoring Company. The Joseph R. Foard Company contended, both before the District Court and the Circuit Court of Appeals, that it was not liable but that the General Stevedoring Company, as an independent contractor, was alone responsible for the injury occasioned by the negligent handling of the dynamite which caused the explosion. But it was held that the General Stevedoring Company was merely the instrumentality of the Joseph R. Foard Company. This conclusion, however, rests upon the facts that the losses of the General Stevedoring Company were paid by the Joseph R. Foard Company, and all of the profits of the former company were kept by the latter company as a charge for managing its business; and, also, that the contract to load the vessel, upon which occurred the explosion, was made with the Joseph R. Foard Company, and that company made no separate contract with the General Steve-

doring Company. The following excerpts from the opinion readily discloses that the facts of that case are quite different from those disclosed by the allegations of the present bill. At page 829 of the decision, Judge Woods, speaking for the Court, said:

> "The District Court was clearly right in holding untenable the position taken by the Foard Company that the loading was done by the General Stevedoring Company as independent contractor and that it alone was responsible for any negligence in handling the dynamite. Whatever may have been the original design when the Foard Company caused to be organized the General Stevedoring Company, the evidence leaves no doubt that the stevedoring, whether done under one or the other corporate names, was in reality but a department of the business of the Foard Company as shipbrokers and agents. The two companies had the same officers; the Stevedoring Company handled no funds, except through the Foard Company; *its losses were paid by the Foard Company and dealt with as if they were that company's own losses. All of the profits of the Stevedoring Company were kept by the Foard Company as a charge for managing the business* . (Italics ours.) There are other like circumstances, but these are sufficient to show that the Stevedoring Company was organized and controlled and its affairs so conducted as to make it a mere instrumentality of the Foard Company. This being so, the two corporations must be regarded, as to the outside public, identical. (Citation of authorities.)
>
> *"But, even if the usual current of business of the two corporations has been separate, in this instance the contract to load the vessel was with the Foard Company, and the evidence tends to show that it made no separate contract with the Stevedore Company, but cooperated with and completely controlled it.* (Italics ours.) The two companies, therefore, will be treated as one in this discussion, to be referred to as the Foard Company."

This Court, in the case of *Linn & Lane Timber Company v. United States, 196 Fed. 593,* decided a suit in equity brought by the United States against the Linn & Lane Timber Company, Charles A. Smith, et al., to annul patents issued for certain lands entered under the Act of Congress, known as the Timber and Stone Act. The lands in question, alleged to have been fraudulently acquired, were conveyed to the Linn & Lane Timber Company, organized by the defendant, Charles A. Smith. That company pleaded that the suit could not lie against it, because it had not been commenced within six years from the date of the patents. This Court, however, treated Charles A. Smith and the corporation as being identical, and annulled the patents, upon the ground that the entire transaction was in fraud of the Government, a condition which brought the facts of that case within one of the exceptions to the recognized rule. This Court, speaking through Judge Gilbert, at page 597 of the Reporter, said:

> "But, assuming that the deeds were in fact delivered to the corporation at the time of its first meeting of its board, it is clear that it should be held, for the purpose of determining the question of the application of the statute of limitations, that Smith was the corporation and the corporation was Smith. He organized the corporation. He owned all the capital stock; he owned all of the lands. Before the corporation was organized and before the patents issued, he knew that the officers of the government were making investigation of the entries, and that there was talk of his indictment by a federal grand jury. The corporation was organized in Minnesota 'as a holding company' of lands in Oregon. Up to the time when the deeds were recorded, September 9, 1908, the corporation had never done any business, had never taken possession of the lands or exercised any act of ownership thereof, and there was nothing of record in any state or county office in Oregon to indicate that the corporation possessed any property in the state or had ever transacted any business there-

> in. There can be no doubt that one at least of the purposes for which it was formed was to conceal fraudulently therein the titles to the lands which are the subject of this suit, and to keep the titles so concealed until the time when the statute of limitations should bar the anticipated suit of the government to set aside the patents."

Immediately following the quotation this court refers to decisions which hold that, when necessary, a court of equity will look beyond the corporate form and into the substance of things to discern the use of a corporation as a cloak for fraud, or for otherwise averting legal responsibilities. But, here again, we find fraud permeating the transaction, a situation dissimilar from the facts disclosed by the bill of complaint in the present case.

Upon the question, generally, of the liability of one corporation for the debts of another by virtue of stock ownership and control, see *Cook on Corporations, 7th Ed., Vol. 1, p. 934, Sec. 317, and Vol. 3, p. 2138, Secs. 663-664.*

DECISIONS CITED IN THE BRIEF OF APPELLANT.

Appellant has been kind enough to serve upon us copies of his brief in ample time for replying thereto. We have carefully read the brief and studied the cases cited therein, some of which have been used in the present brief for the purpose of justifying the action of the trial court in dismissing the bill for insufficiency of facts to constitute a cause of action. Unfortunately, appellant has used random quotations from a few of the decisions cited in his brief, without disclosing the facts thereof. It has been our purpose to select, for the enlightenment of the Court, those decisions which, in our opinion, were elucidative of the rule of law now involved. We have not hesitated to show that the courts, in proper cases, would disregard corporate entity, but it has been our purpose to show that none of the courts

have done so upon facts similar to those disclosed by the allegation of the complainant's bill of complaint.

Appellant has evidently concluded that courts of equity would hold one corporation liable for the debts of another merely by virtue of the fact that one corporation held a majority, or all, of the stock of another, and thereby controls its affairs. The decisions do not bear him out in this conclusion, but on the other hand the fiction of corporate entity is only disregarded in the plainest cases, and then only when it appears that one corporation is using the other for fraudulent purposes, or as a mere agent or instrumentality for averting responsibility. Appellant has cited no decisions, and there are none, which hold one corporation responsible for the obligations of another, when it appears that both are dealing with the public at arm's length, as the bill of complaint herein discloses. All of the decisions cited by appellant in support of his contention that the Development Company is responsible for the debts of the Copper Company involve facts very dissimilar to those presented by complainant's bill of complaint. Most of them we have heretofore distinguished.

The case of *Central Trust Company v. Nealand, 138 U. S. 114,* involved the liability of a mortgagor for property acquired subsequent to the execution of the mortgage and does not treat upon the question of liability of one corporation for the obligations of another.

In the case of *McVickers v. American Opera Company, 40 Fed. 861,* the plaintiff, McVickers, instituted suit against the defendant for breach of contract for the use of his theater. Thereafter the National Opera Company was organized and the assets of the American Opera Company were transferred to it. This action, as held by the Court, had the effect to hinder and defraud McVickers in the prosecution of his suit for the collection of his debt. Instead of holding its assets in trust for the creditors, the

American Opera Company, being insolvent, endeavored to place them where the creditors could not reach them. Of course the two companies could not maintain their separate corporate existence for such a purpose.

The case of *In re Alaska, American Fish Company, et al., 162 Fed. 498,* does not bear upon the question here involved at all, but, on the other hand, treats upon the question whether the business of catching and preserving fish is "principally engaged in manufacturing" within the meaning of the Bankruptcy Act of 1898; and whether the District Court of Washington would have jurisdiction in bankruptcy over both a California and Washington corporation, it having first acquired jurisdiction.

The case of *In re Southwestern Bridge & Iron Company, 133 Fed. 568,* discloses that a petition in bankruptcy was filed in Kansas against a Kansas and an Oklahoma corporation. Thereupon a petition was filed against the Oklahoma corporation, in Oklahoma, where a receiver was appointed. A plea was made to the jurisdiction of the District Court of Kansas over the Oklahoma corporation, and that court held that it, having first acquired jurisdiction, would retain it, and proceeded to a final adjudication and determination of the rights of the creditors to the property which was common both to the Kansas and Oklahoma corporation. No question of separate corporate entity was involved.

The case of *In re Horgan, et al., 97 Fed. 319,* held that where a corporation was organized as a mere fiction, and the assets of a partnership were transferred to it, that the corporation should deliver to the referee its books for examination. The question of liability of the corporation for the partnership debts was not involved, but merely whether the referee in the bankruptcy proceedings of the partnership could inspect the books of the corporation.

In the case of *Colonial Trust Company v. Monticello Brick*

Works, 172 Fed 310, the question was involved whether a corporation organized in Delaware by residents of Pennsylvania, for the purpose of owning stock and financing certain Pennsylvania corporations was transacting business within the State of Pennsylvania contrary to the requirements of law of that State, so that its contracts made therein were void and unenforceable. The District Court held that it was conducting business contrary to the laws of Pennsylvania, so that its contracts were void and unenforceable as a claim in the bankruptcy court, and this ruling was affirmed by the Circuit Court of Appeals for the Third Circuit. The facts there involved have no relation whatsoever to those under present consideration.

In the case of *Salt Lake Valley Canning Company, et al., v. Collins, 176 Fed. 91,* this court held valid an order of a referee in bankruptcy consolidating, for convenience of administration, a proceeding in bankruptcy against a partnership and its members, with a bankruptcy proceeding of a corporation, which was owned entirely by one of the partners. No question of liability of the one for the debts of the other was involved.

In the case of *Western Union Telegraph Co. v. United States & Mexican Trust Company, et al., 221 Fed. 545,* it was held that a purchase, through a foreclosure sale, or otherwise, of the property of an insolvent corporation by a new corporation, pursuant to a plan or scheme of the bondholders and stockholders of the insolvent company, whereby the stockholders thereof derived, by receipt of stocks or bonds of the new company, or otherwise, benefits equal to or greater than those received by or openly offered to and rejected by its general creditors, is fraudulent in law as to the latter, and renders the new corporation and the property purchased at such sale liable for the claim of such creditors against the old company, at least to the extent of the value of the interest secured by the stockholders of the old com-

pany in excess of the value of the interest secured by, or openly offered to and rejected by the unsecured creditors.

The Copper Company did not organize the Development Company to purchase its property at the foreclosure sale so as to constitute a fraud upon the creditors of the Copper Company, nor does it definitely appear from the bill of complaint herein that the Development Company was the purchaser at the foreclosure sale under a deed of trust of the property of the Copper Company, and even if it were the bill is insufficient of fact to disclose that such a sale and purchase constituted a fraud upon the creditors of the Copper Company.

The case of *In re McCarthy Portable Elevator Company, 196 Fed. 247,* discloses that McCarthy caused to be organized the McCarthy Portable Elevator Company to promote his patented device. Of the 1,000,000 shares of stock McCarthy owned 899,999 shares. The corporation became bankrupt and McCarthy presented his claim for $10,180.00, of which $7,600.00 was for compensation at the rate of $500.00 per month for services rendered. The referee ordered the claim allowed and petition was made to the District Court for a review of his order. The question involved was whether the corporation should be responsible for the payment of compensation to McCarthy, in view of the fact that it was organized by him merely for the purpose of promoting his patent. The Court said:

> "If McCarthy had not formed a corporation, but sought to perfect and market his patented device as an individual no compensation would have been allowed him for services rendered in case of his bankruptcy. Why should he be allowed such compensation for performing the same services for a like purpose simply because he did it as an officer of a corporation, which was his own creature and made to serve his individual interest? To do this would be to declare that the form rather than the substance, a shadow rather than the real, governs the right. The law is not so imbecile."

The situation in that case was merely tantamount to McCarthy presenting a claim against himself for services rendered, which, of course, was discountenanced.

THE FACTS OF THE BILL OF COMPLAINT ARE INSUFFICIENT TO BRING THE CASE WITHIN THE EXCEPTIONS TO THE GENERAL RULE OF SEPARATE CORPORATE EXISTENCE, AS DISCLOSED BY THE DECISIONS.

Our reading of the cases impress us with the fact that *fraud* controlled the decision of most of them. How different is the situation here! The trustee of the bankrupt Copper Company asks this court to appropriate, toward the payment of its debts, property of the Copper Company, which has been judicially sold to satisfyy its pre-existing debts, and this, in spite of the fact that the highest court of the State of Arizona has declared that sale regular and valid in all respects. See *Martin v. Bankers' Trust Company, supra.*

The bulk of the indebtedness, which appellant seeks to collect from the Development Company, consists of the bankrupt's notes made to the Development Company. He asserts the validity of these claims, thereby recognizing the separate corporate entities of the two companies. The bankruptcy court, according to appellant's allegations, has already allowed those claims, including a claim by the Development Company in the sum of thirty-nine thousand four hundred and twenty-three and 2/100 ($39,423.02) dollars. (Tr. of Rec., p. 14-16.) It does not appear that appellant objected in the bankruptcy court to the allowance of these Development Company's notes as claims against the bankrupt Copper Company. Such a procedure was followed *In re McCarthy Portable Elevator Co., 196 Fed. 247,* last cited. Appellant might well have opposed the allowance of these

claims against the bankrupt upon the ground which he now urges, and at that time contested the validity of his present contention that the Copper Company could not be indebted to the Development Company. But now, after the bankruptcy court has allowed those claims, has listed the Development Company as one of the creditors of the Copper Company, and has proved the validity of more than one million dollars of promissory notes, made by the Copper Company to the Development Company, and negotiated by the latter company to the Empire Trust Company, National Park Bank, Thomas W. Joyce, and Philbin, Beekman, Menken & Griscom, thereby necessarily negativing appellant's present contentions, he seeks to force the Development Company to pay these very notes. He does this upon the theory that all of those debts were debts of the Development Company.

Appellant does not claim that the Development Company was a mere agent or instrumentality of the bankrupt, but that the bankrupt, on the other hand, into whose shoes he has stepped, was a mere agent and instrumentality of the Development Company. If he is right there should be no bankruptcy proceedings against the Copper Company, because its assets all belong to the Development Company. By his own allegations he seeks to nullify the separate corporate entity of his own bankrupt for the purpose of rendering the Development Company responsible for the debts of the Copper Company. In supporting this theory he puts forward authorities holding that, upon a proper showing, the corporate entity of a subsidiary corporation may be ignored and all of its assets drawn into the bankruptcy estate of the parent company. But he cites no authority which lends any support, whatever, to his contention that, as trustee of the Copper Company, the alleged agent and instrumentality of the Development Company, he has a right to resort to the parent company to satisfy the proved and

allowed claims against the Copper Company, whose trustee he is.

Manifestly, when the Copper Company, upon petition of certain of its creditors (Tr. of Rec. p. 13) was adjudged bankrupt, its corporate character was affirmed, and its separate corporate entity conceded. Each and every creditor whose claim was proved and allowed against the Copper Company made oath that it, not the Development Company, owed the debt. They thereby affirmed and recognized its separate corporate entity. How then may appellant, as representing these creditors be permitted to assert rights against the Development Company that neither the creditors nor the bankrupt would be heard to assert?

While asserting that the Copper Company was a mere agent and instrumentality of the Development Company, thereby rendering the latter liable to the creditors of the former, appellant, in the next breath, alleges that the Smelting Company and the Railroad Company were dummy corporations organized, controlled and managed by the Development Company, which caused the capital stock of those companies to be held by another dummy of the Development Company, namely, the Copper Company, of which appellant is trustee in bankruptcy. (Tr. of Rec. p. 6.) But, as to these two dummies, appellant concluded, and so alleges, that the shares of their capital stocks constituted assets of the Copper Company, diverted from its creditors by the foreclosure proceedings. That is to say, under appellant's theory, the dummy Copper Company drew to itself all of the assets of the dummy Smelting Company and Railroad Company, its fellow offsprings of the Development Company, and thereupon turns about and annexes all of the assets of the parent of all of them, and all of this upon the flexible theory that this court should ignore all corporate entities except that of his bankrupt, the Copper Company.

When we turn to appellant's theory that he should have a lien upon all of the mining properties sold upon foreclosure, and should be declared the owner of the shares of stock of the Railroad and Smelting Companies, sold upon the same foreclosure, we find it more curious, if possible, than his theory of personal liability of the Development Company. The mortgage from the Copper Company is not claimed to have been fraudulent or invalid in any particular. It was given to secure payment of two million dollars of bonds of the Copper Company. It covered and included the mining properties and shares of stock now sought to be claimed through the benevolent interposition of a court of equity. Appellant does not question the validity of the mortgage debt. He shows that foreclosure proceedings were begun in the State Court on July 3, 1911 (Tr. of Rec. p. 11), before the bankruptcy proceedings were instituted (Tr. of Rec. p. 13); and that a decree of foreclosure was entered under which these properties were sold for one hundred and two thousand ($102,000.00) dollars (Tr. of Rec. p. 12) to Leo Goldschmidt of Tucson, Arizona. In such a manner these properties of the Copper Company were applied to a satisfaction of a mortgage debt, the validity of which is not questioned. But it is claimed, without bringing Leo Goldschmidt before the Court, that he was a mere agent of the Development Company and that therefore, although the mortgage debt was valid, and even if it were the judgment creditor and had a perfect right to become the purchaser at the foreclosure sale, nevertheless, because it did so, it must now give up the property and lose its debt as well, in order that the property may be devoted to the payment of unsecured creditors of the Copper Company. It is marvelous, indeed, that such ingenuity should be displayed in a court of equity, or that a trustee in bankruptcy should hope to clothe himself in sought-for equities to which the bankrupt and the bankrupt's creditors could hardly raise

their eyes. It will at once be apparent that appellant should have contested the mortgage foreclosure, if he thought the mortgage invalid, or if any defense existed. The decree was entered December 28, 1914 (Tr. of Rec. p. 12). Appellant became trustee July 2, 1914 (Tr. of Rec. p. 17). Upon the record the mortgage must be taken as valid, the foreclosure sale as regular, and the entire proceedings proof against collateral attack, placing the mines and shares of stock beyond the reach of the trustee of the Copper Company, in payment of whose valid debts they have already been applied, and whose equity and title therein have been foreclosed by a decree of another court of competent jurisdiction.

Again, this property is sought to be appropriated towards a payment of the debts of the Copper Company, because complainant is *informed* and *believes* (Tr. of Rec. p. 11, paragraph XII, Bill of Complaint) that Leo Goldschmidt, who is not joined as a party to this action, bought it in at the foreclosure sale for the use and benefit of the Development Company. What a superficial allegation to destroy that peculiar attribute of a corporation, namely, the separateness between it and the stockholders who compose it! The complainant is not satisfied because the property of the Copper Company has been sold to satisfy the conditions of the trust deed executed by the Copper Company, but he now wants a court of equity to assist him to the extent that the same property may again be used by the Copper Company for the payment of its bankruptcy claims. What use he will then want to make of the property is not yet disclosed.

For aught that appears from the bill of complaint, the Development Company never contracted a debt. There is no allegation that a single creditor of the Copper Company dealt with it upon the representation that the Development Company would stand responsible for its debts. The creditors of the Copper Company, whom complainant repre-

sents, made their obligations with it, and not with the Development Company. All the property now sought to be appropriated towards the payment of the Copper Company's debt, was primarily in the possession of that company, and was sold to pay the secured creditors of that company.

Every fact of the bill of complaint seems to negative complainant's contention that the Copper Company was the instrumentality, adjunct, etc., of the Development Company. The assets of the Copper Company (and it does not appear that the Development Company had any assets) were judicially sold to pay its obligation. The Development Company is not asking any court to do one thing, which would deprive the creditors of the Copper Company of one penny. The bill of complaint does not disclose that anything fraudulently was done which inured to the advantage of the Development Company, its creditors and stockholders, or to the disadvantage of the Copper Company, its creditors and stockholders. The deed of trust, which was secured by the property of the Copper Company was recorded in Pima County, Arizona, where it operated, so that the most uncautious creditor was given notice that the pecuniary responsibilities of the Copper Company were thus burdened. Do these facts warrant a court of equity foisting upon the Development Company the debts of the Copper Company? We submit that the legal fiction of separate corporate entity is too essential for the development and maintenance of legitimate business for a court of equity to destroy that legal fiction upon such superficial and indefinite allegations as complainant has presented here.

We confidently submit that none of the cases involving the question now engaging the court's attention are authority for holding the Development Company liable for the Copper Company's debts, under the allegations of complainant's bill of complaint.

For all of which reasons the order of the lower court, dismissing complainant's bill for insufficiency of fact to constitute a valid cause of action in equity against defendant, should be affirmed.

All of which is respectfully submitted.

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